

Budget and Taxes 101

2nd Edition



Senate Ways and Means Committee

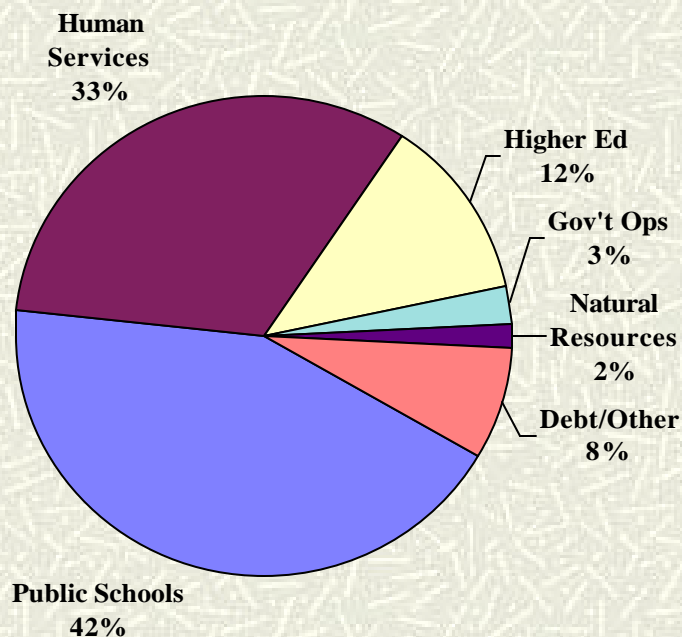
January 16, 2002



The Ways: The Washington State Budget

How big is the General Fund-State (GF-S) Budget and how is it spent?

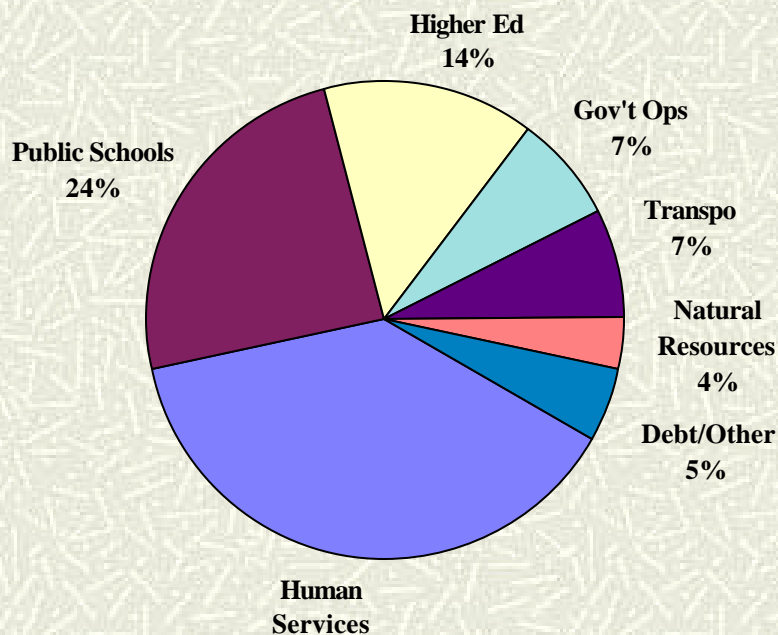
Washington State 2001-03 General Fund-State Budget



(Dollars in Billions)	
Public Schools	\$9.9
Human Services	7.4
Higher Education	2.8
Governmental Operations	0.6
Natural Resources	0.4
Debt Service/Other	1.7
Total	\$22.8

The Total Funds Budget is more than double the GF-S budget

Washington State
2001-03 Total Funds Budget*



(Dollars in Billions)

Human Services	\$19.1
Public Schools	12.0
Higher Education	7.2
Governmental Operations	3.6
Transportation	3.6
Natural Resources	1.7
Debt Service/Other	2.5
Total*	\$49.7

* Includes budgets for Omnibus Operating, Transportation, and Capital New Appropriations
(excludes Capital Re-appropriations, approximately \$1.6 billion).

The “Hidden Budget” or “Funds, Funds, Funds”

All funds are authorized in statute. For 2001-03, there are :

➤ **198 Appropriated Funds**

An appropriated fund is a fund that is held in the state treasury.

➤ **72 Non-Appropriated, Budgeted Funds**

A non-appropriated budgeted fund is a fund outside the state treasury whose expenditures are subject to allotment. An allotment is an agency’s plan of estimated expenditures and revenues for each month of the biennium.

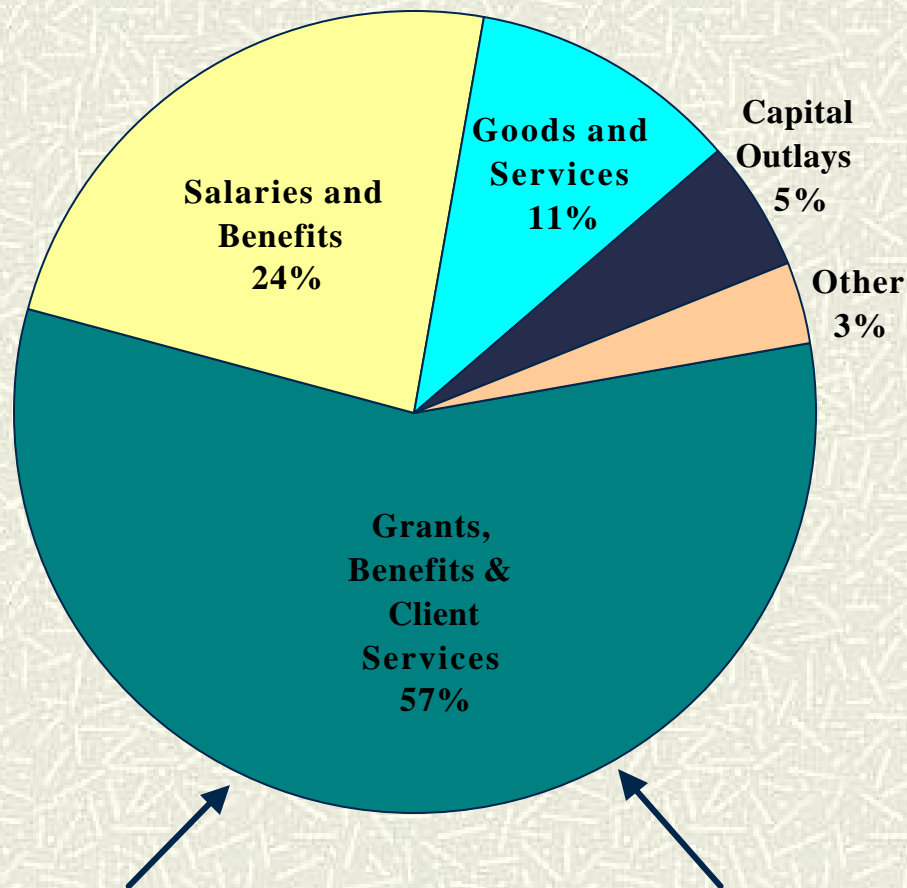
➤ **74 Non-Budgeted Funds**

A non-budgeted fund is a fund whose expenditures are not subject to appropriation or allotment control. These include:

- trust funds (e.g. Pension Investment Accounts)
- business enterprise funds (e.g. Higher Ed Bookstore Accounts)
- working capital funds (e.g. The Local Government Distribution Fund)

Most state spending is for Grants, Benefits and Client Services

Washington State Total Expenditures for FY2001



Includes:

- Direct grants to clients
- Direct payments to providers
- Distributions to local governments and school districts

Source: AFRS fiscal year 2001 actual expenditures for operating and capital budgets

Some of the largest Grants, Benefits and Client Services Are:

	FY2001 \$ Millions
Department of Social and Health Services Payments to hospitals nursing homes, many other service providers, welfare and child care payments	\$5,455
Superintendent of Public Instruction Apportionment and other grants to school districts	5,276
Community, Trade, and Economic Development Local Government Grants, Energy Assistance, ECEAP, and many other federal and state grant programs	451
State Lottery Lottery Prizes	292
Washington State Health Care Authority State employee benefits and the Basic Health Plan	285
Department of Health Grants to local governments and providers for public health improvement, WIC, Vaccines, HIV drugs	215
Board of Education Common School Construction	143
Stadium and Exhibition Center Distributions Seahawk stadium and exhibition hall	136
Higher Education Coordinating Board Financial aid for students in higher education	120
Employment Security Department Worker training grants	113
Transportation Improvement Board Grants to cities and counties to address transportation issues.	110
Ecology Watershed planning, toxic cleanup, Centennial Water Fund	104
Other Grants, Benefits, & Client Services	458
Total Grants, Benefits, & Client Services	\$13,157

Source: AFRS fiscal year 2001 actual expenditures for operating and capital budgets

Goods and Services include:

	FY2001 <u>\$ Millions</u>
Contractual Services	\$426
Routine support services including data processing, interpreter services, security, food service	
Supplies and Materials	387
Office supplies, medications at state operated hospitals, food at colleges and institutions, laboratory supplies, inmate clothing, research related materials	
Rentals and Leases	311
Office rentals, janitorial services, leased copiers, alterations and improvements	
Equipment under \$5,000	176
Personal Computers, desks, classroom seating, lab equipment	
Communications	150
Repairs and Maintenance	135
Utilities	133
Other Goods and Services	742
Printing, insurance training, archives, commission for liquor and lottery sales, vehicle maintenance	
Total Goods and Services	\$2,461

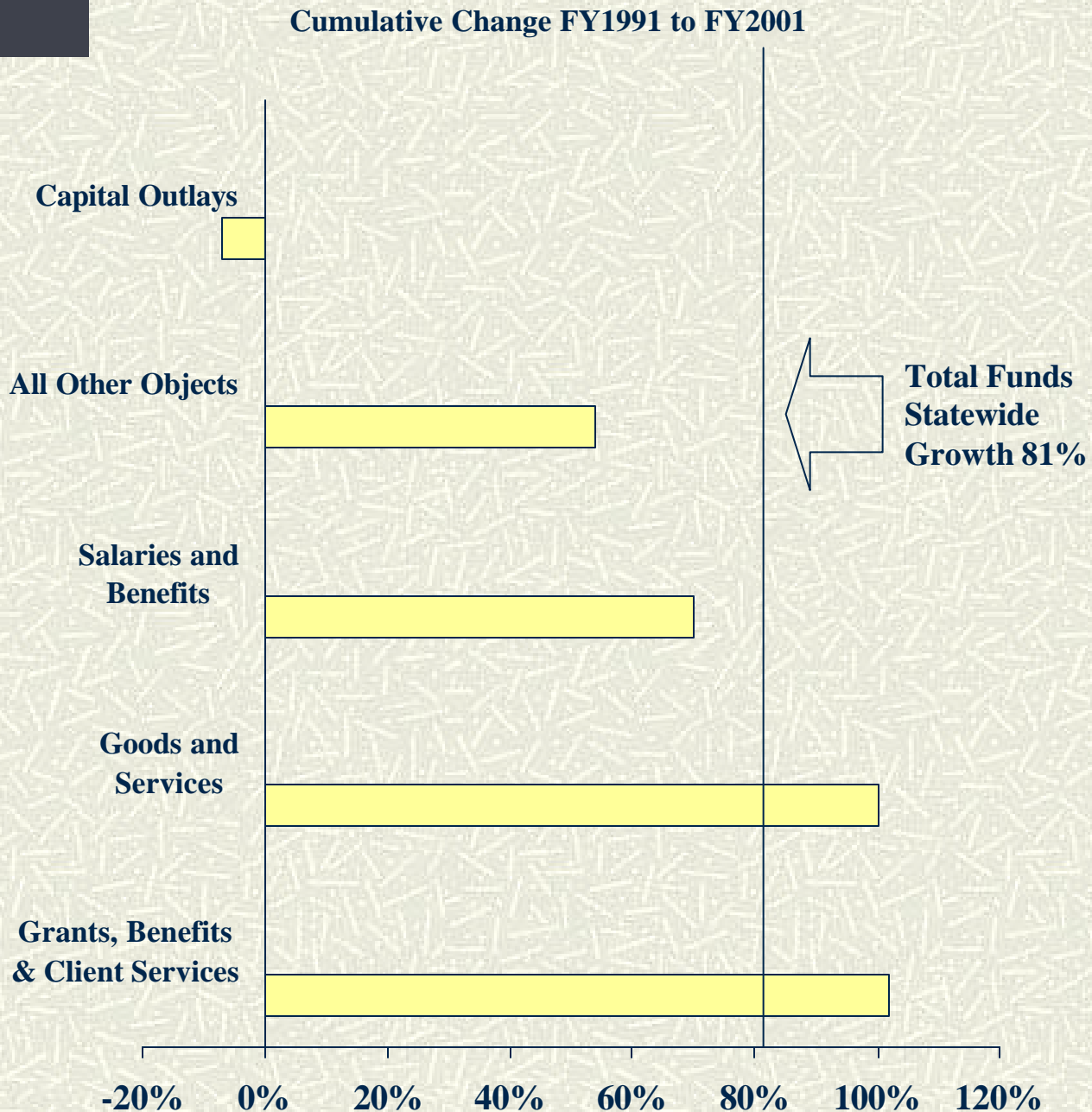
Source: AFRS fiscal year 2001 actual expenditures for operating and capital budgets

“Other” includes:

	FY2001
	<u>\$ Millions</u>
Debt Service	\$838
Personal Service Contracts	218
Marketing - tobacco awareness, Guaranteed Tuition Program, Tourism	
WASL development	
State Investment Board funds management information systems	
WSP Criminal History System	
Administrator for the Courts Juvenile Tracking System	
Travel	128
Transfers	-445
Used to account for transfers among agencies, programs, and accounts	
Total Other Objects	\$740

Source: AFRS fiscal year 2001 actual expenditures for operating and capital budgets

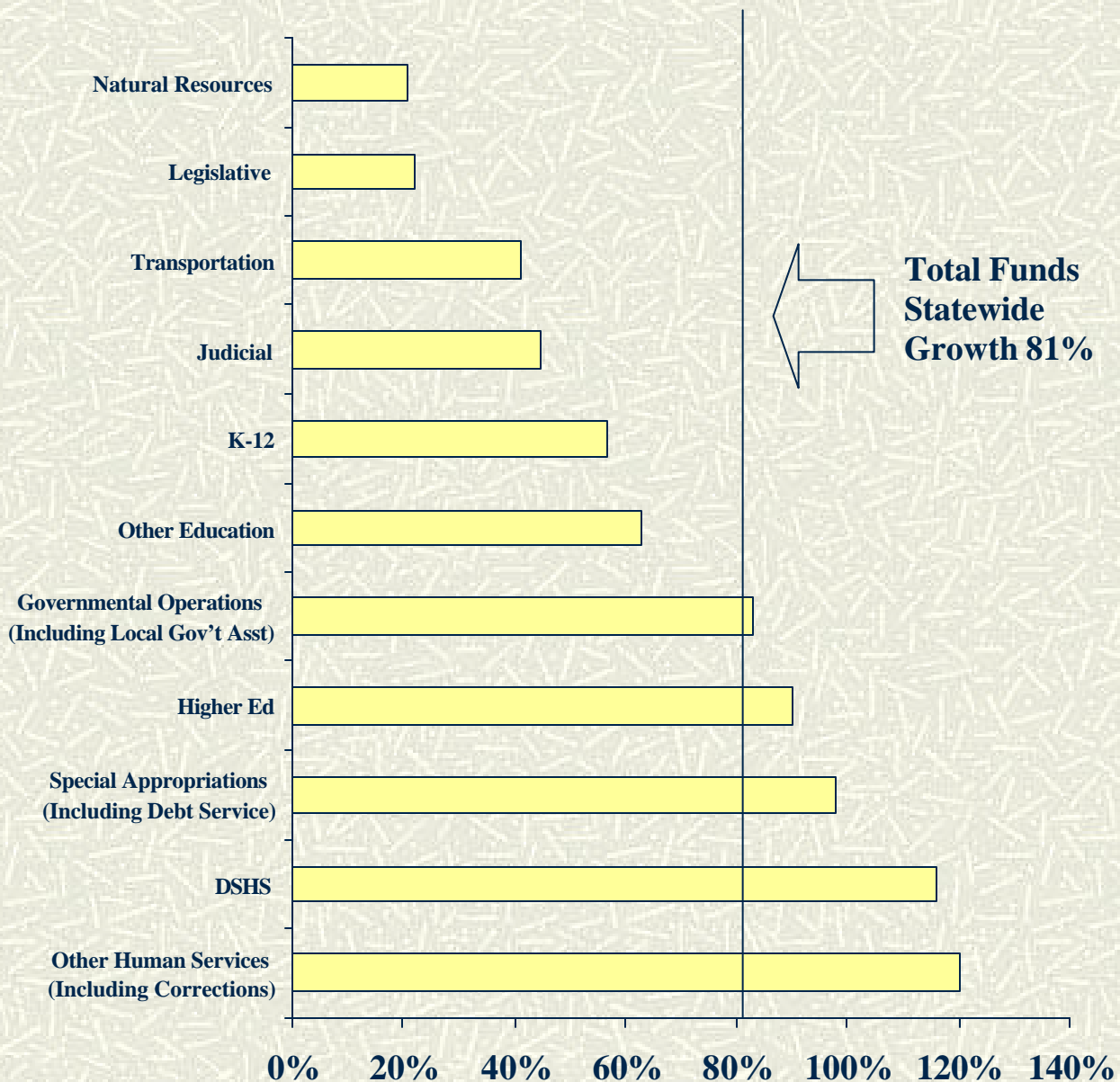
Over the Last 10 Years, the portions of the Total Funds Budget spent on Goods and Services, and on Grants, Benefits and Client Services have grown faster than the budget as a whole



Source: LEAP recast history database

Human Services, Debt Service, and Higher Education have grown faster than the Total Funds Budget as a whole

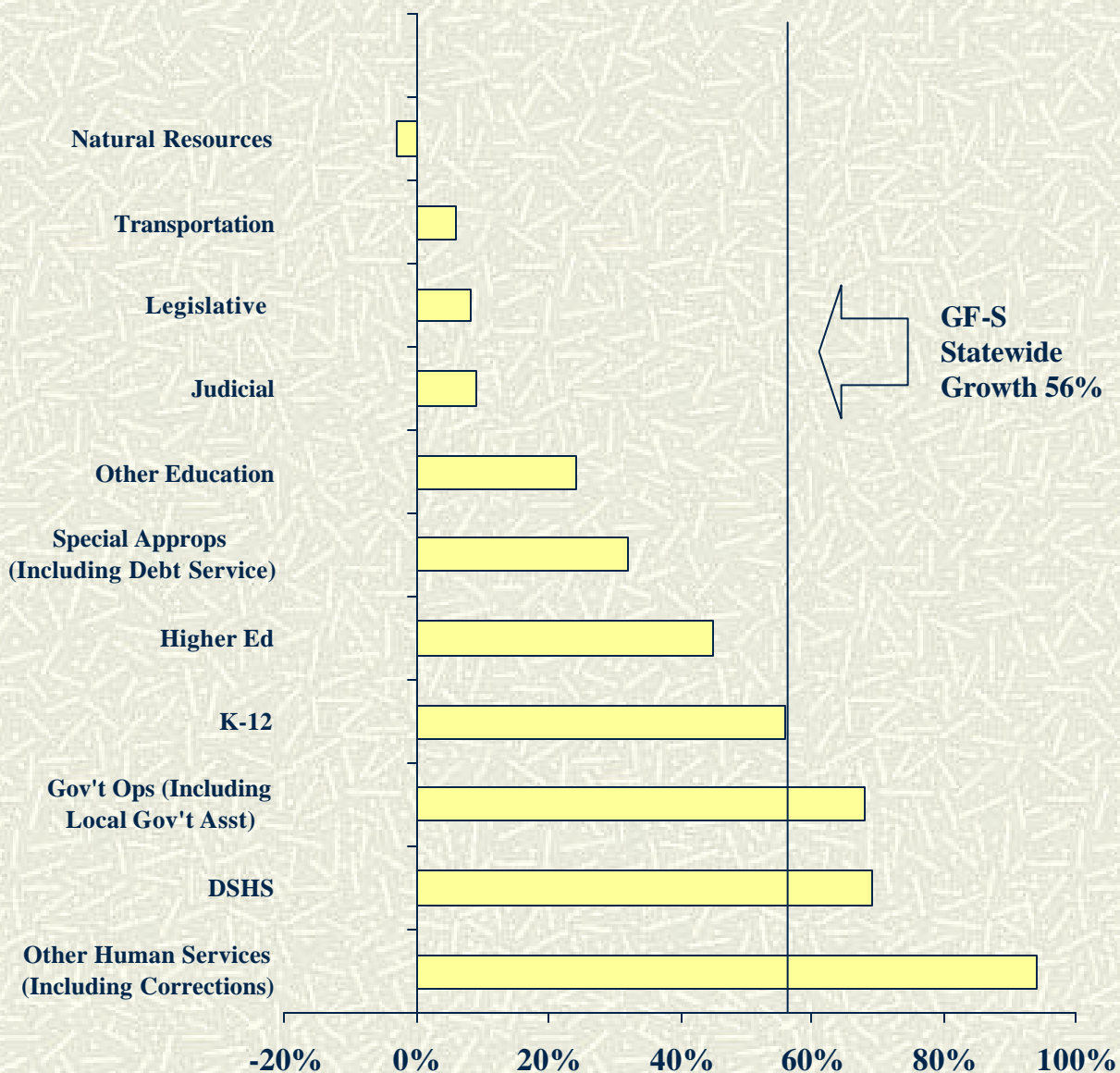
Cumulative Change FY1991 to FY2001




Source: LEAP recast history database

Human Services, Governmental Operations, and K-12 have grown faster than the GF-S Budget as a whole

Cumulative Change FY1991 to FY2001



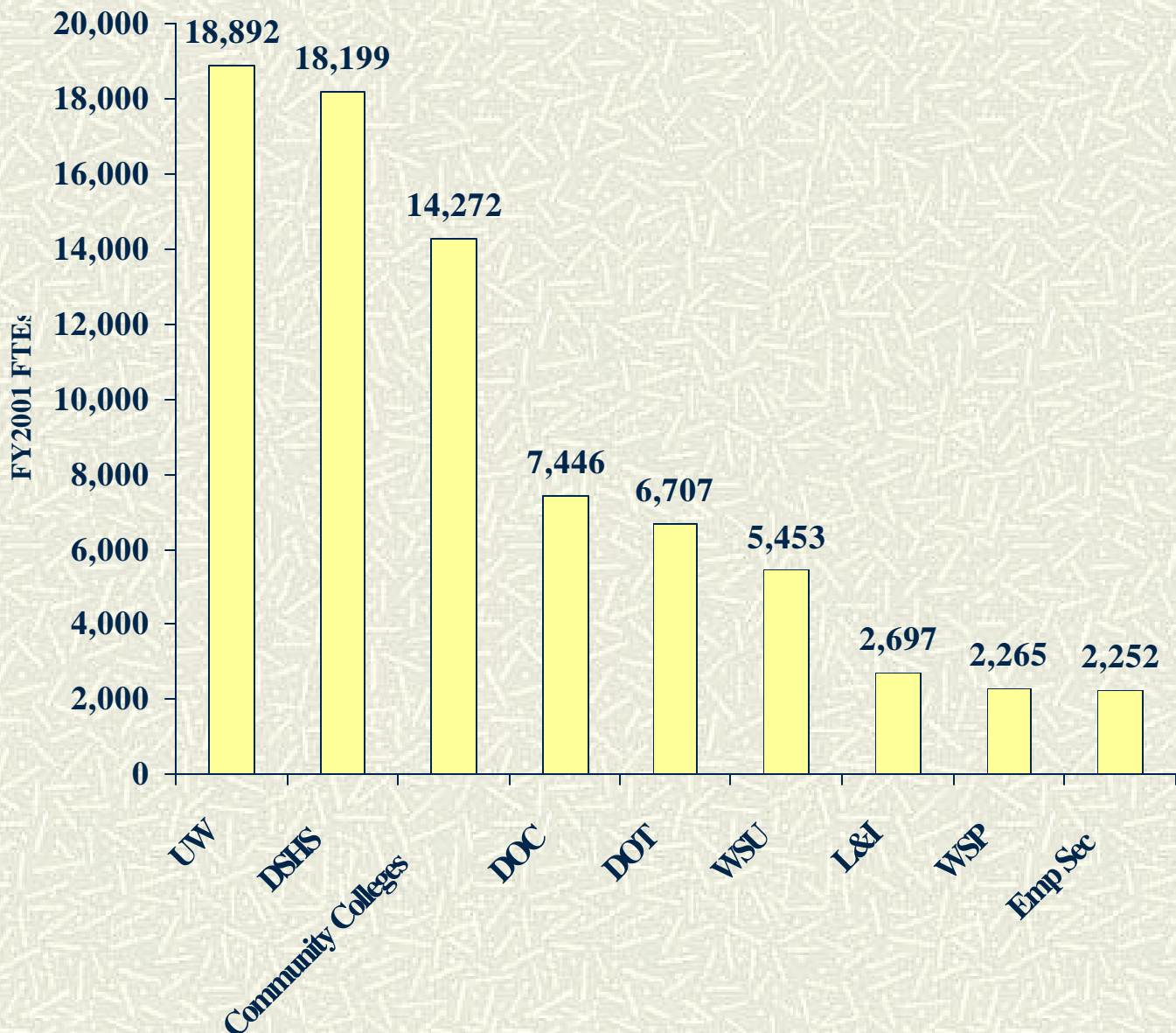
Source: LEAP recast history database



**Where are All Those
FTEs and Why are
There 102,042 of
Them?**

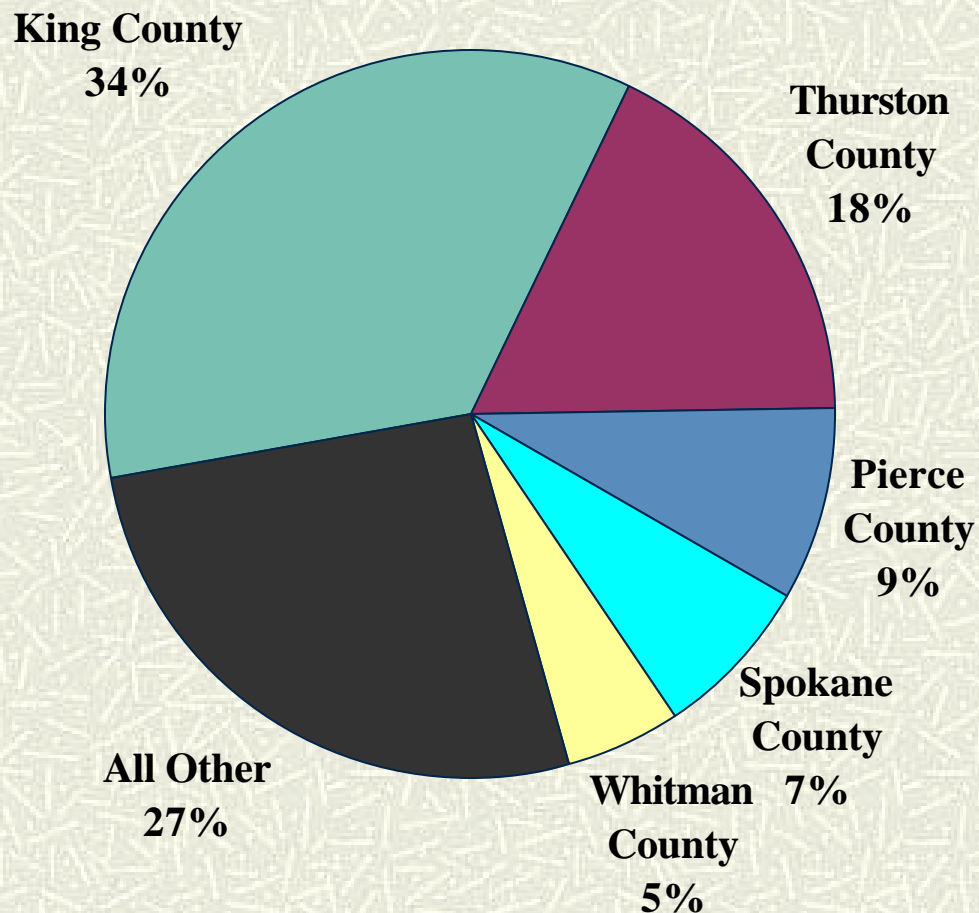
UW & DSHS are the largest state agencies

(The 9 agencies below represent 75+% of the total number of FTEs)



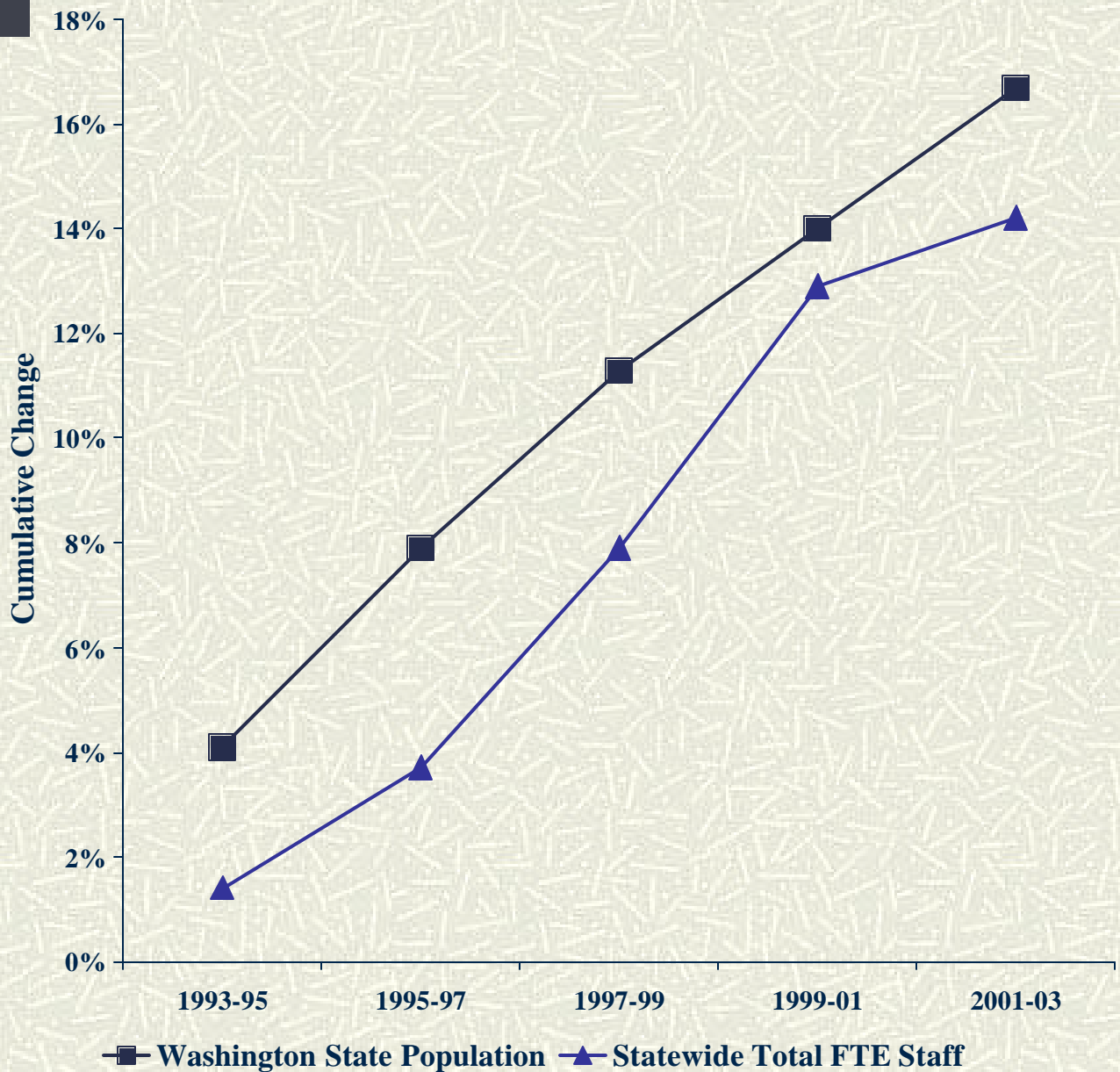
Source: Monitor (AFRS) database FY2001 actual FTE staff for Operating & Capital Budgets

Most state employees work in King and Thurston Counties



Source: Department of Personnel Data Warehouse, December 2000-November 2001 headcount

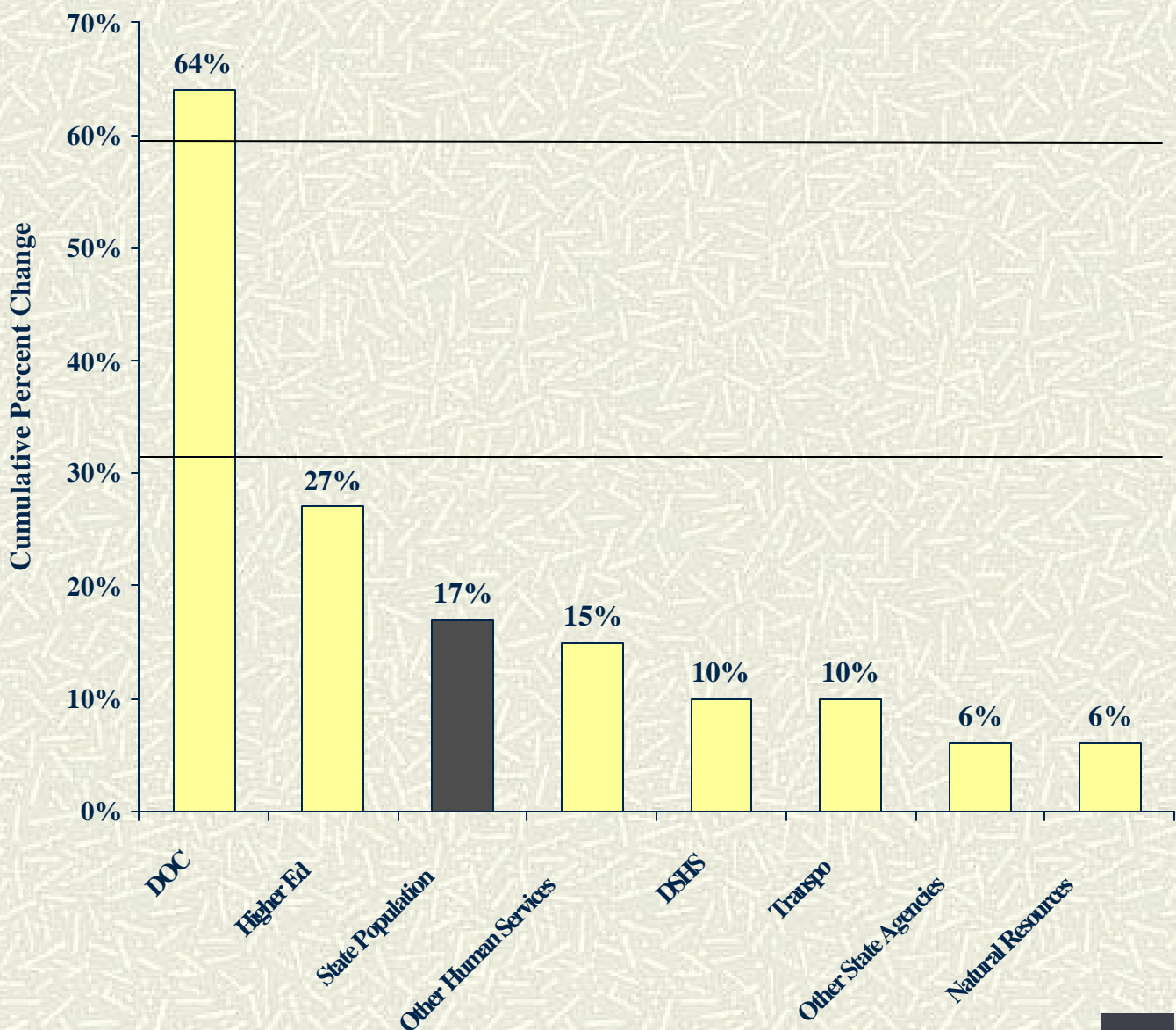
Total state employment growth rates have been generally slower than the growth in the state population




Source: LEAP recast history database and Governor's proposed 2001-03 Supplemental; population data from Economic and Revenue Forecast, November 2001.

However, Corrections and Higher Education staff have been growing faster than state population over the last 10 years

Cumulative Change FY1991 to FY2001



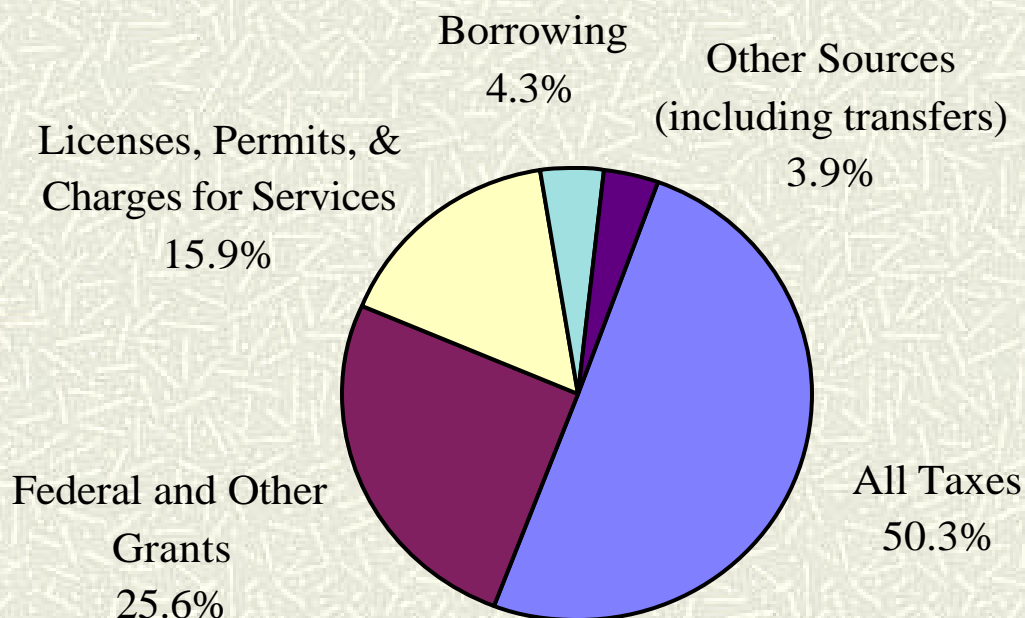
Source: LEAP recast history database



The Means: Major Taxes in Washington State

Most State Revenue Comes from Taxes

(2001-03 Dollars in Billions)

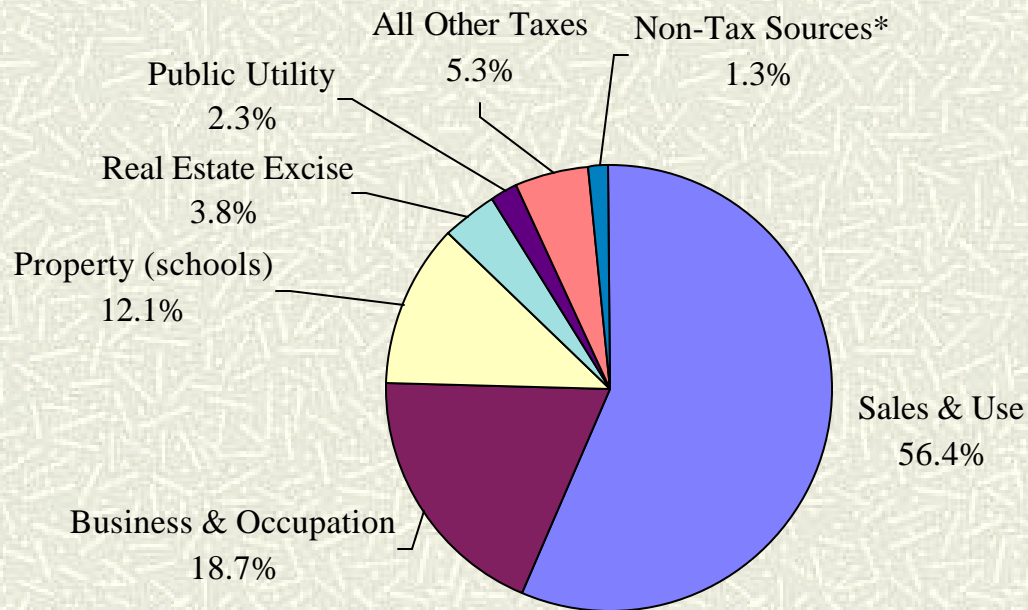


All Taxes	\$25.1
Federal and Other Grants	12.8
Licenses, Permits, & Charges for Services	7.9
Borrowing	2.1
Other Sources (including transfers)	1.9
Total	\$49.9

Note: Includes non-general fund sources

The State General Fund is Heavily Dependent on the Sales & Use Tax

(2001-03 Dollars in Billions)



Sales & Use	\$12.0
Business & Occupation	\$4.0
Property (schools)	\$2.6
Real Estate Excise	\$0.8
Public Utility	\$0.5
All Other Taxes	\$1.1
Non-Tax Sources*	\$0.3
TOTAL	\$21.2

* Includes licenses, permits, fees, liquor profits, and earnings on investments

Major State Tax Revenue Sources

- Washington has 3 major tax sources:
 - Sales & Use Tax
 - Business and Occupation Tax
 - Property Tax
- Washington has no personal or corporate net income tax
- These taxes constitute 87% of General Fund revenues

Sales and Use Taxes

- \$12.0 billion for 2001-03
- 56.4% of General Fund
- Tax Base:
 - Sales Tax: Retail sales of goods and some services
 - Use Tax: Items acquired without payment of sales tax (e.g, out-of-state purchases)
- Tax Rate: 6.5% of selling price
 - Plus local option taxes
 - Combined state & local rate varies from 7.0 to 8.9%
 - 4th highest combined rate nationally

Major Sales & Use Tax Exemptions

(2001-03 Dollars in Millions)

➤ Services	\$5,090
• Business Services	1,960
• Consumer Services	650
• Financial Services	1,440
• Medical Services	1,040
➤ Food Products	1,240
➤ Gasoline	620
➤ Manufacturing Machinery	338
➤ Prescription drugs	285
➤ Automobile & other trade-ins	215

Business and Occupation Tax

- \$4.0 billion for 2001-03
- 18.7% of General Fund
- Base: Business gross receipts
 - No deductions for the cost of doing business
- Principal rates:

• Wholesaling	0.484%
• Retailing	0.471%
• Services	1.5%
- Pyramiding
 - Tax imposed at each level of activity
 - Multiple activities tax credit

Major Business and Occupation Tax Exemptions

(2001-03 Dollars in millions)

- Public grants to nonprofit health/social welfare organizations \$90
- 1st mortgage interest 70
- Agriculture 55
- Small business credit 53
- Hi-tech R&D credit 50

Property Tax

- \$2.6 billion for 2001-03
- 12.1% of General Fund
- Base: Assessed value (AV) of property
- Rate: Varies each year
 - Total state & local average rate for 2001 is \$12.96
- Constitutional 1% Limit
 - Taxes limited to \$10 per \$1,000 AV without voter approval
- Statutory Rate Limits
 - State: \$3.60 per \$1,000 AV
 - Most Others: \$5.90 per \$1,000 AV
- Statutory Revenue Limit
 - Total tax levy increase of each district limited to 1% (Initiative 747)

Major Property Tax Exemptions

(2001-03 Dollars in Millions)

• Intangible property	\$3,038
• Public property	789
• Motor vehicles	250
• Business inventories	221
• Household goods	118
• Senior citizens	41

Exemptions result in tax shifts/losses

- Taxable value decreases
- Tax rates increase to compensate
 - Taxing district loses revenue to the extent the district cannot increase rate because of statutory rate limit
 - Higher taxes for other taxpayers because of higher rates

Major Changes in Taxes since 1993

- 1993 General Fund and Health Services Account Tax Increases
- Legislative Tax Reductions since 1993
- 2000-01 Initiatives

1993 Tax Increases

1993-95 Biennium

- Increase B&O taxes on service businesses - \$330 M
- Temporary B&O surtax on all businesses - \$106 M
- Added some services to the retail sales tax - \$80 M
- Insurance Prepayments tax on HMOs - \$90 M
- Increased “sin taxes” for the Health Services Account - \$249 M

Major Tax Reductions since 1993

(Dollars in Millions)

Session	General Fund Taxes	Biennial Amount
1994 Session	Hi Tech tax incentives	(\$68.4)
	Distressed Area exemption	(34.7)
	Temporary B&O Surtax Reduction	(40.1)
	Small Business Tax Reduction	(39.9)
1995 Session	Manufacturing Tax Exemption	(148.5)
	One time Property Tax relief	(54.4)
1996 Session	B&O Rate Decrease on Services	(210.9)
	Repair and Replacement	(42.1)
	R&D Equipment	(26.4)
1997 Session	Property Tax Reduction (Ref. 47)	(205.5)
	Continue 4.7% cut (HB1417)	(26.4)
	B&O Rollback	(94.3)
1998 Session	MVET tax cut only (Ref. 49)	(257.0)

Recent Revenue Initiatives

➤ Initiative 728 (2000)

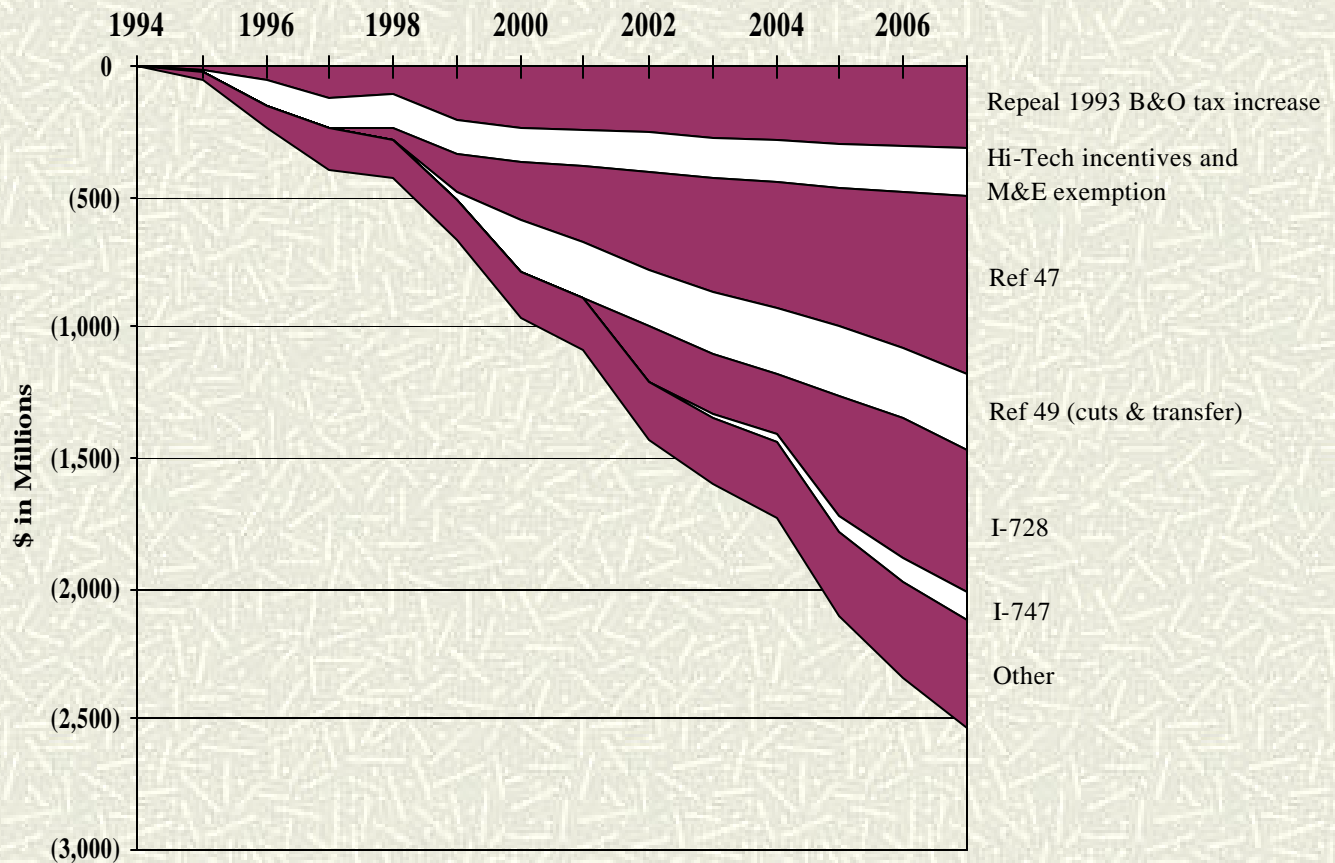
- Dedicated a portion of the state property tax to the student achievement account-\$238 M
- Dedicated the remainder of the lottery for education purposes - \$204 M
- \$442 M state revenue impact 2001-03

➤ Initiative 747 (2001)


- Limited district levy increases to 1%
- \$25 M state revenue impact 2001-03
- \$115 M local revenue impact 2001-03

The impact of revenue decreases since 1994 have been cumulative

Reductions to the General Fund since 1993



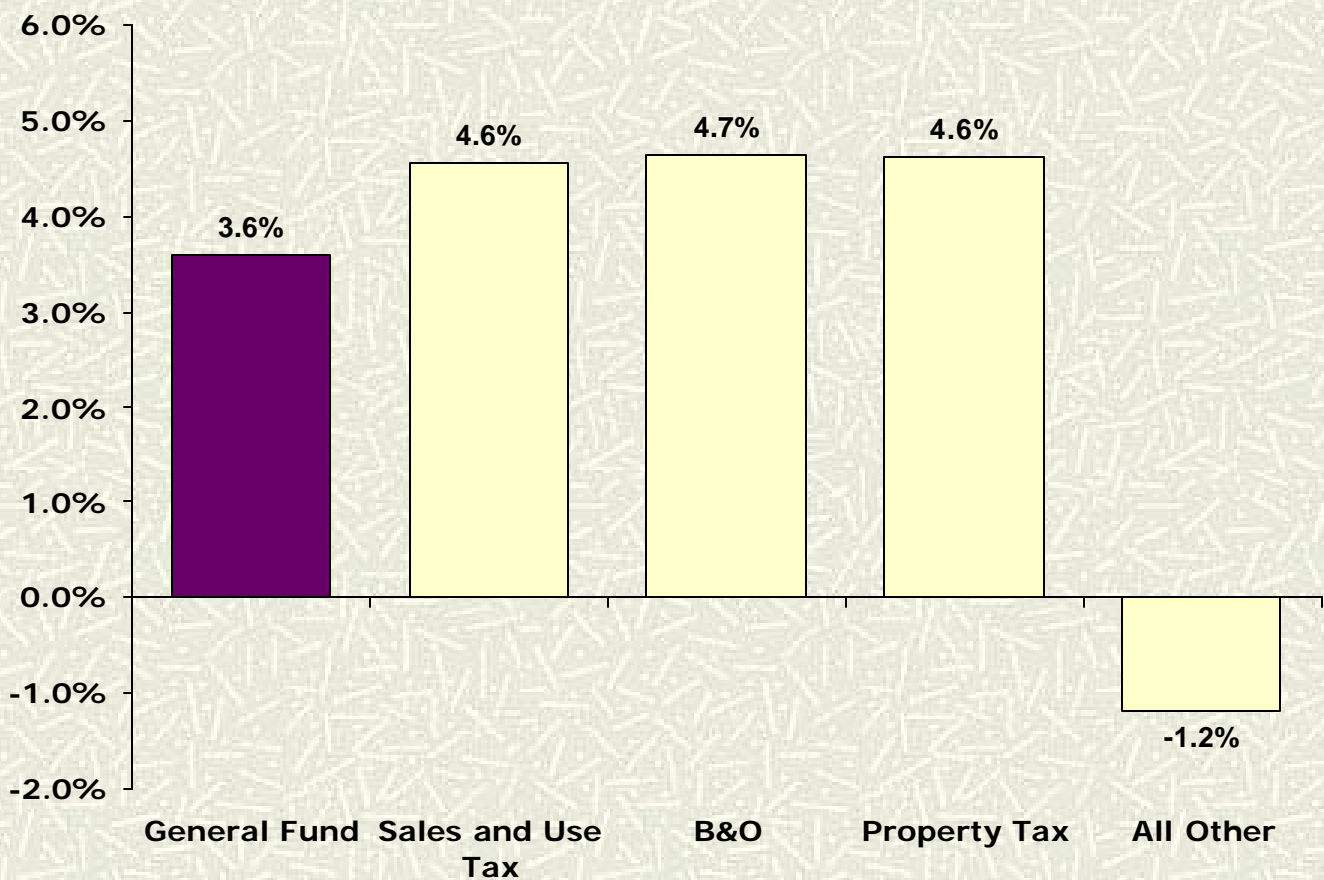
Source: Legislative fiscal staff estimates



Historical Growth in General Fund Taxes

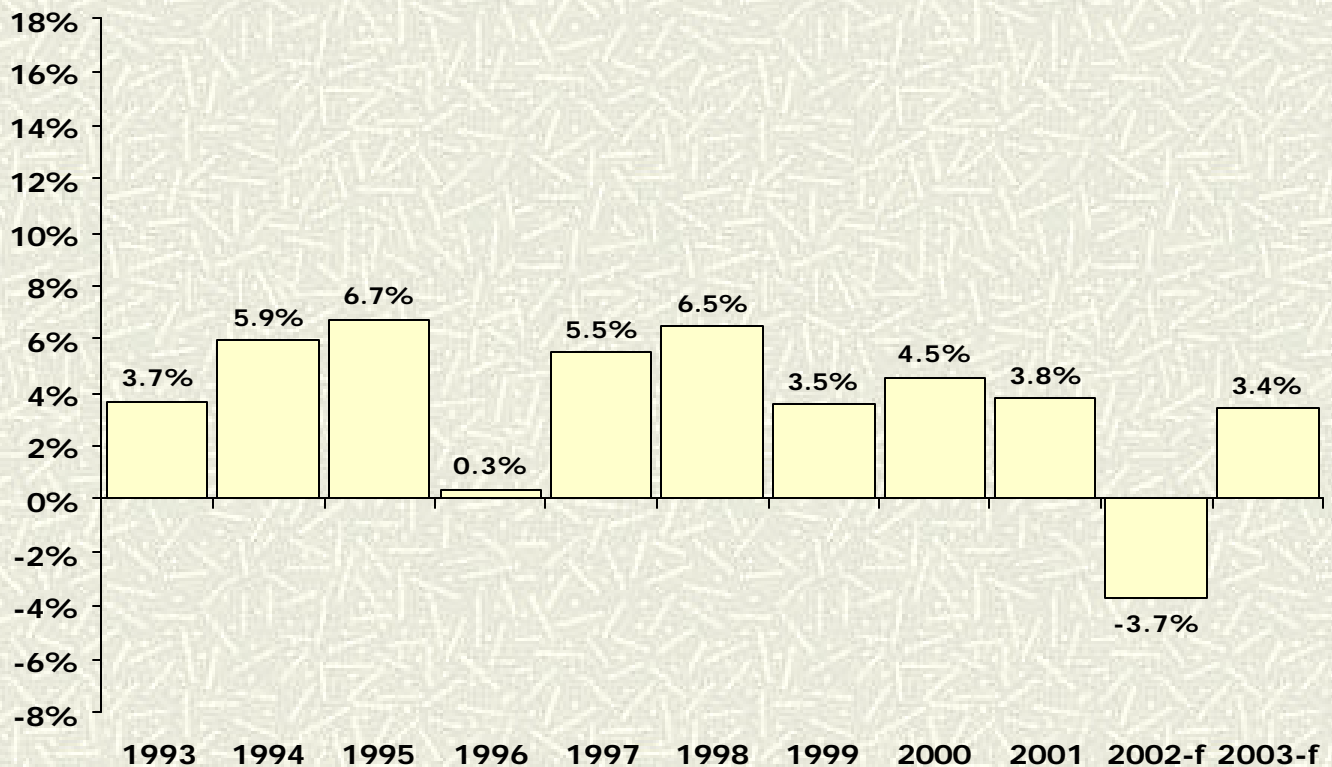
The major General Fund Tax sources have grown faster than the "other" sources

FY1992 to FY2003 Forecast



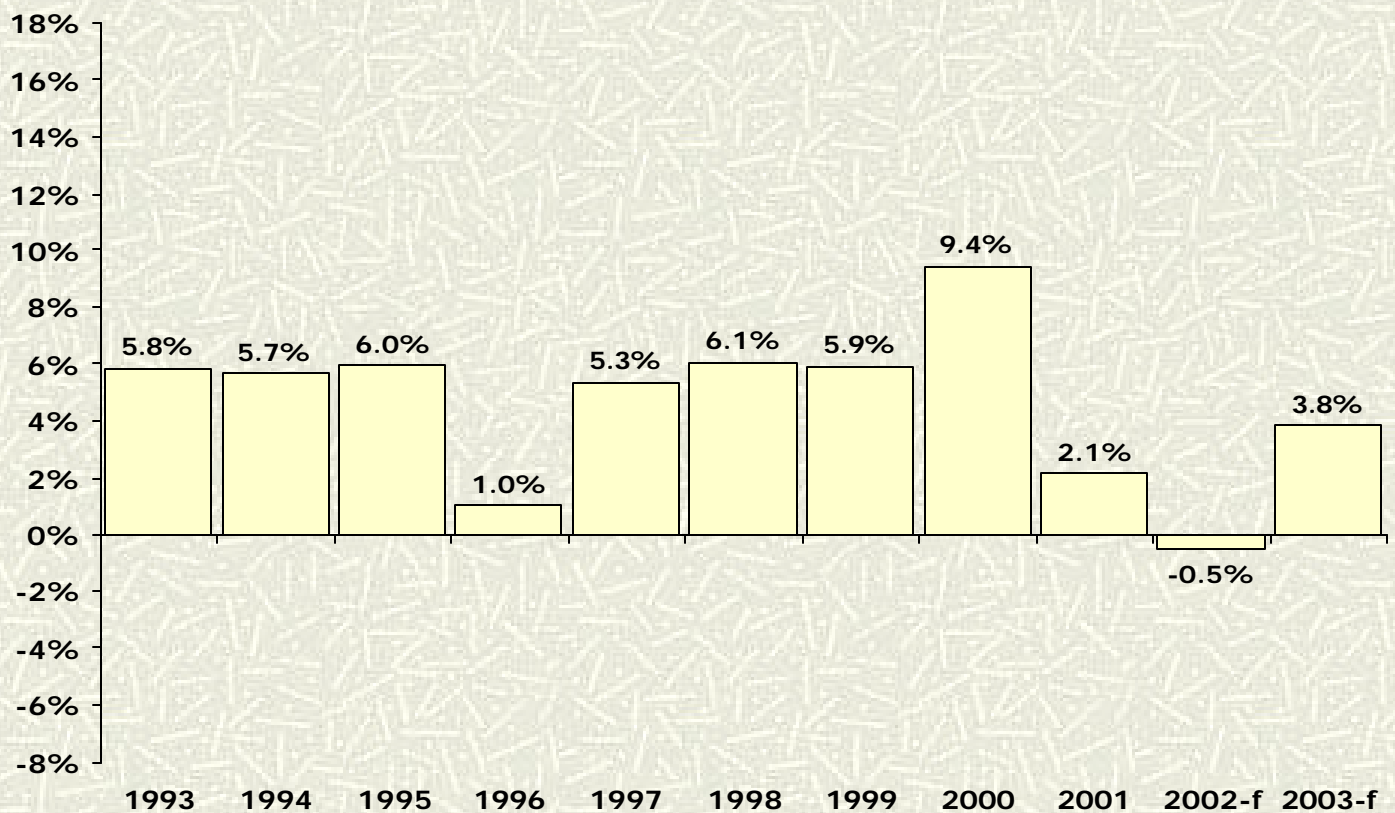
Source: Economic and Revenue Forecast, November 2001

The steady revenue growth ended in 2002 when the impact of initiatives and the recession hit the general fund



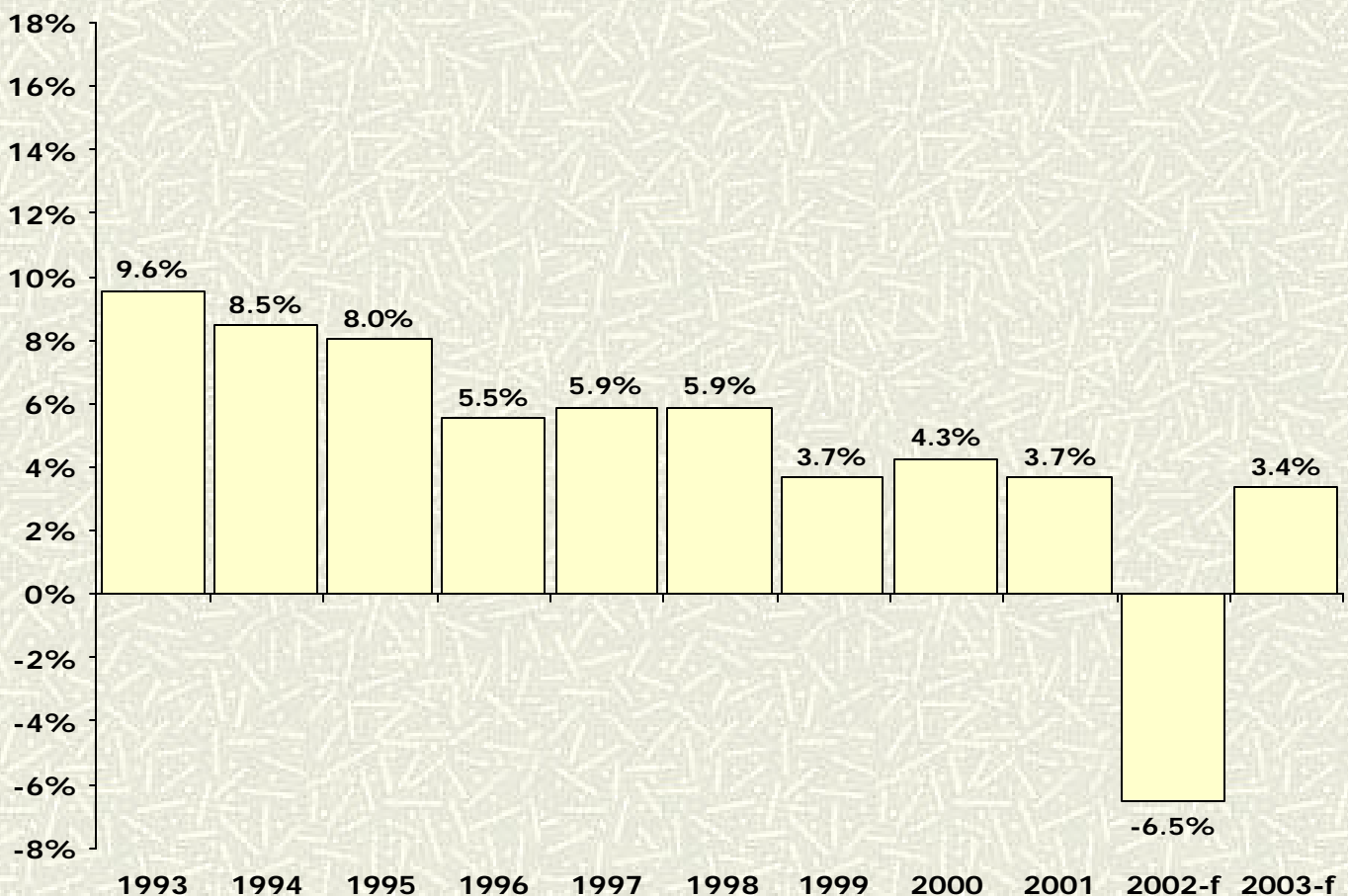
Source: Economic and Revenue Forecast, November 2001 (f=forecast)

Retail Sales (and Use) taxes are closely tied to the overall economy and have fallen quickly from a very high level



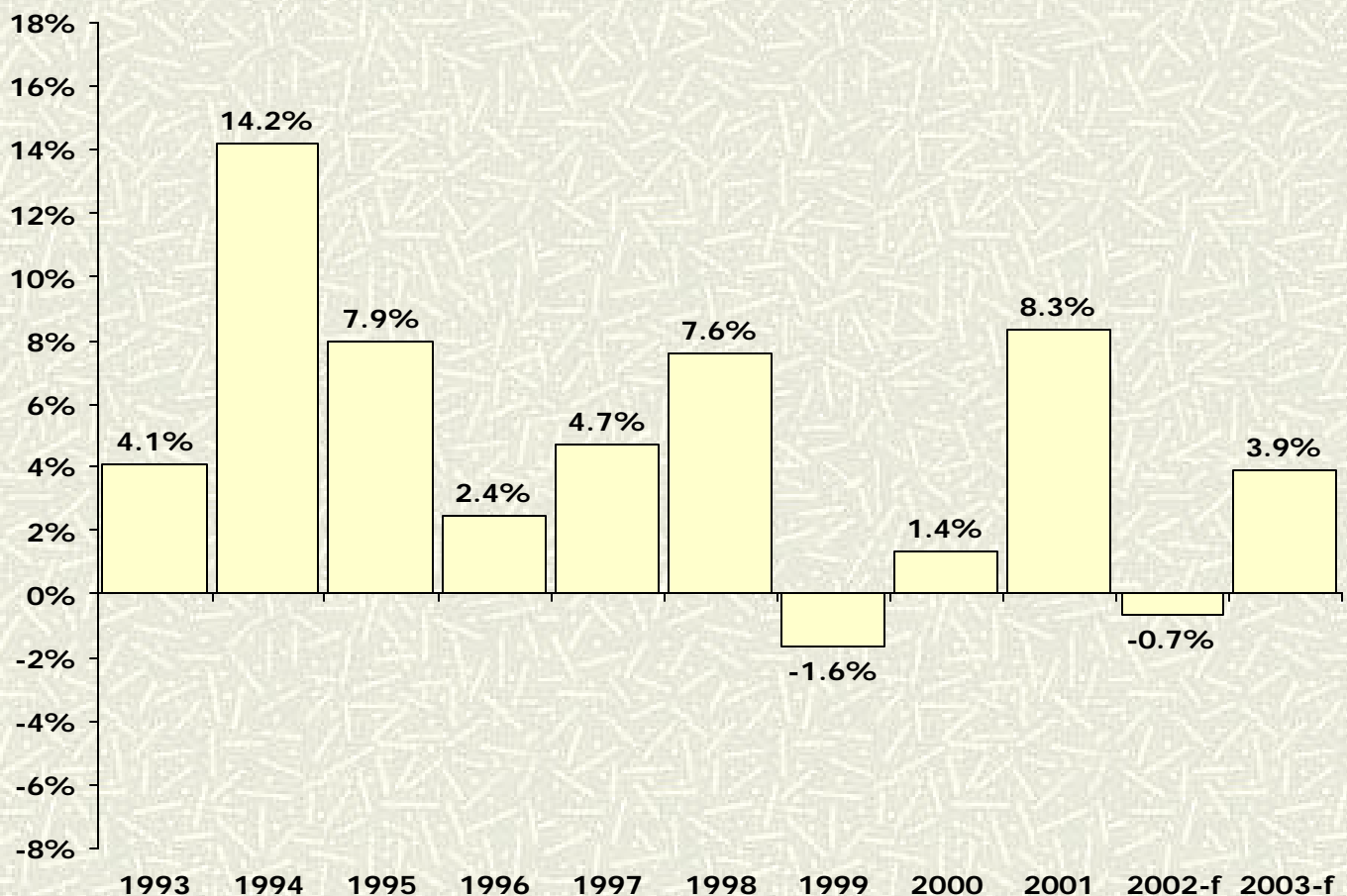
Source: Economic and Revenue Forecast, November 2001 (f=forecast)

The growth in the state Property Tax has been reduced due to statutory changes and the passage of referenda and initiatives



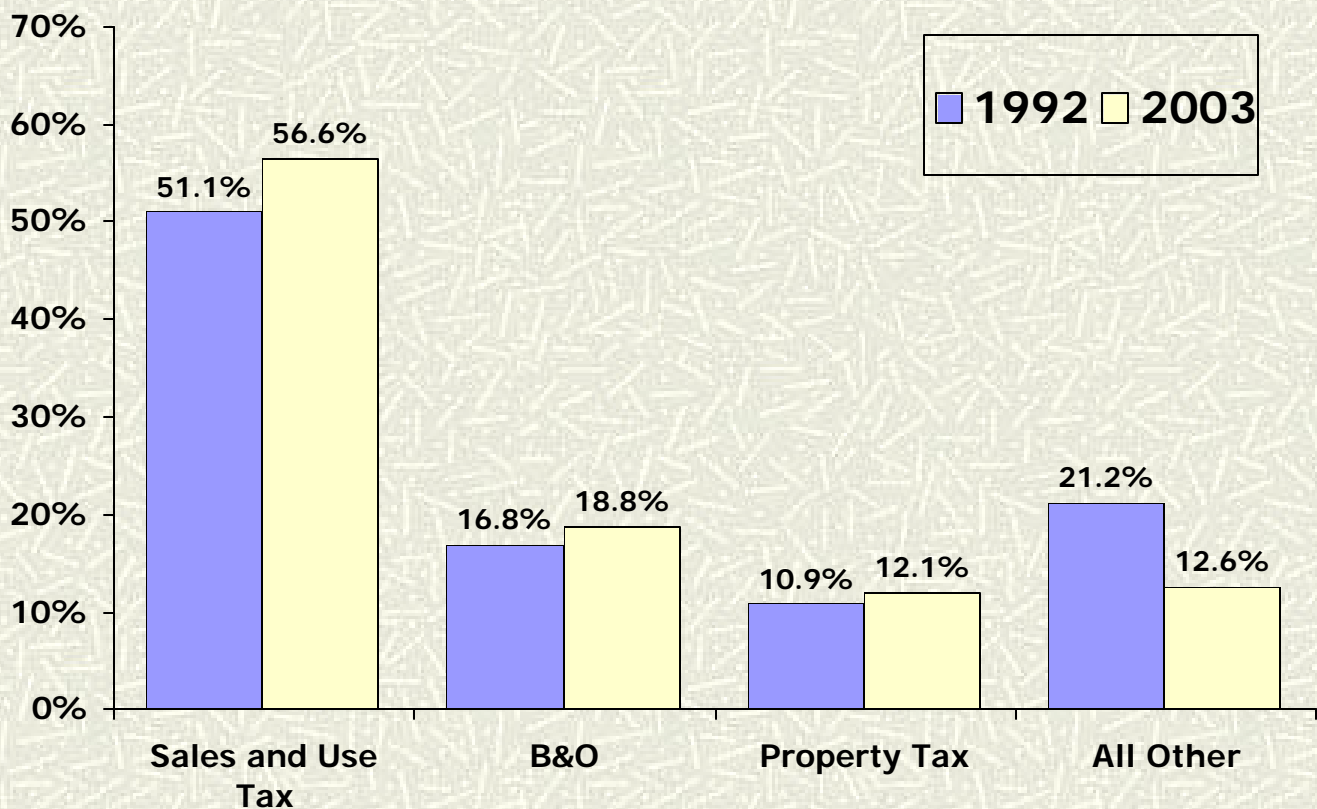
Source: Economic and Revenue Forecast, November 2001 (f=forecast)

The volatility of the Business and Occupation tax is due in large part to significant tax rate changes




Source: Economic and Revenue Forecast, November 2001 (f=forecast)

The primary result of the tax and budget changes since 1992 is that the major revenue sources now make up a larger share of the General Fund



Source: Economic and Revenue Forecast, November 2001 (f=forecast)



The State Budget & Accounting Act: Rumors, Myths, & Facts

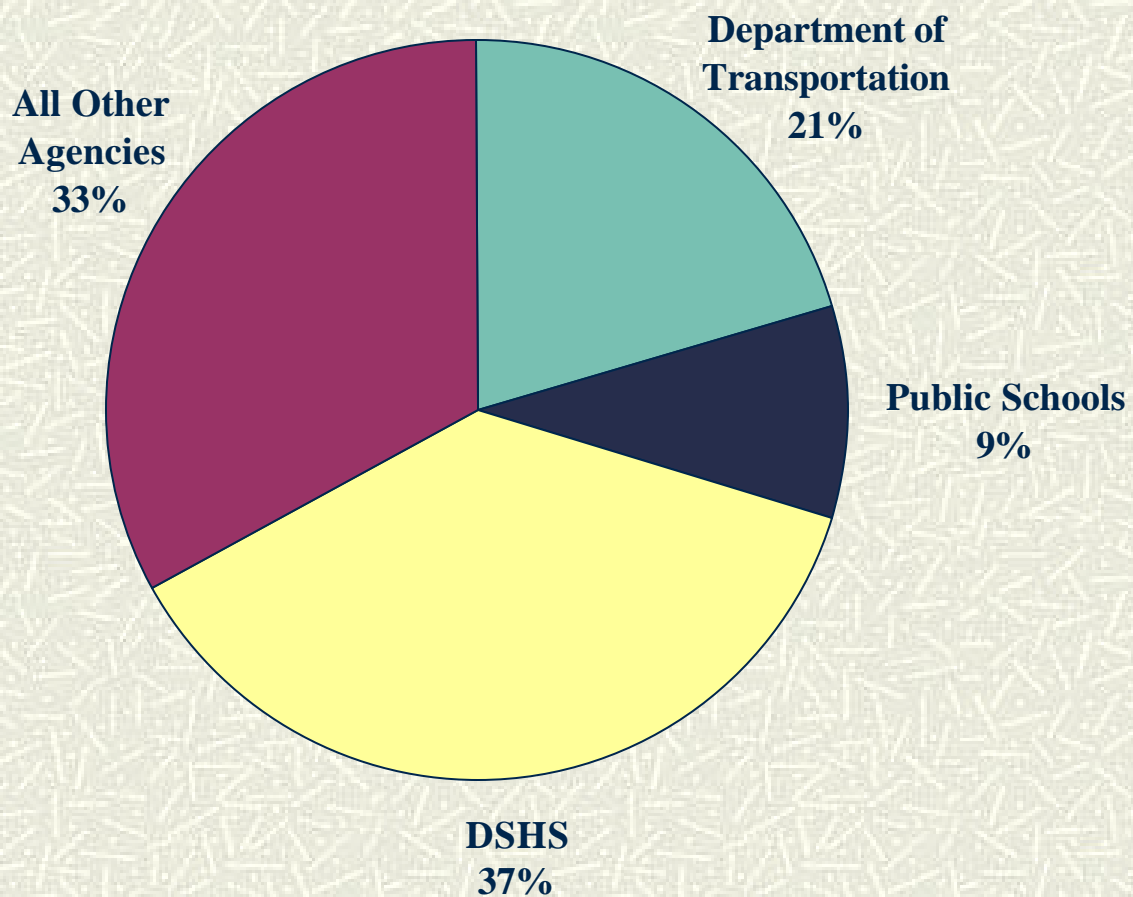
Must the state have a balanced budget?

- Neither state law nor the state Constitution requires a balanced budget.
- Art. 8 of the state Constitution allows the state to incur debt for periods up to 30 years. The Constitution does not distinguish between capital and operating purposes.
- The Budget & Accounting Act requires the Governor to submit to the Legislature a budget proposal within existing revenues.

What are “unanticipated receipts”?

- OFM may approve agency expenditures, outside of the appropriation process, for revenue that “was not anticipated in the budget approved by the Legislature.”
- Unanticipated receipts consist primarily of federal revenues and private grants.
- The unanticipated receipt process does not apply to moneys in the state treasury.

The state spent \$268 million in Unanticipated Receipts in 1999-2001



Source: Office of Financial Management

Can the Governor make “across-the-board reductions”?

- The Governor is required to make “across-the-board reductions” in expenditures to prevent a cash deficit in any fund or account.
- Across-the-board reductions cannot be made to appropriations that are contractually obligated (pensions, debt service) or constitutionally required (basic education).
- The “separation of powers” doctrine prevents the Governor from making reductions that vary from program to program. (*Talmadge v. Washington*, 1982)

Can the state invest in the stock market?

- Article 12 of the state Constitution prohibits the state from being “interested in the stock of any company.”
- The Constitution was amended to allow stock investments with public pension funds (1967), industrial insurance trust funds (1985), and the developmental disability endowment (2000).

How has Initiative 601 changed?

- The State Expenditure Limit allows state General Fund expenditures to grow by the “fiscal growth factor” – the average rate of state population increase and inflation for the previous three fiscal years. For next biennium, the growth factor is 5.9 percent.
- All General Fund revenue in excess of the spending limit is placed in the Emergency Reserve Fund.

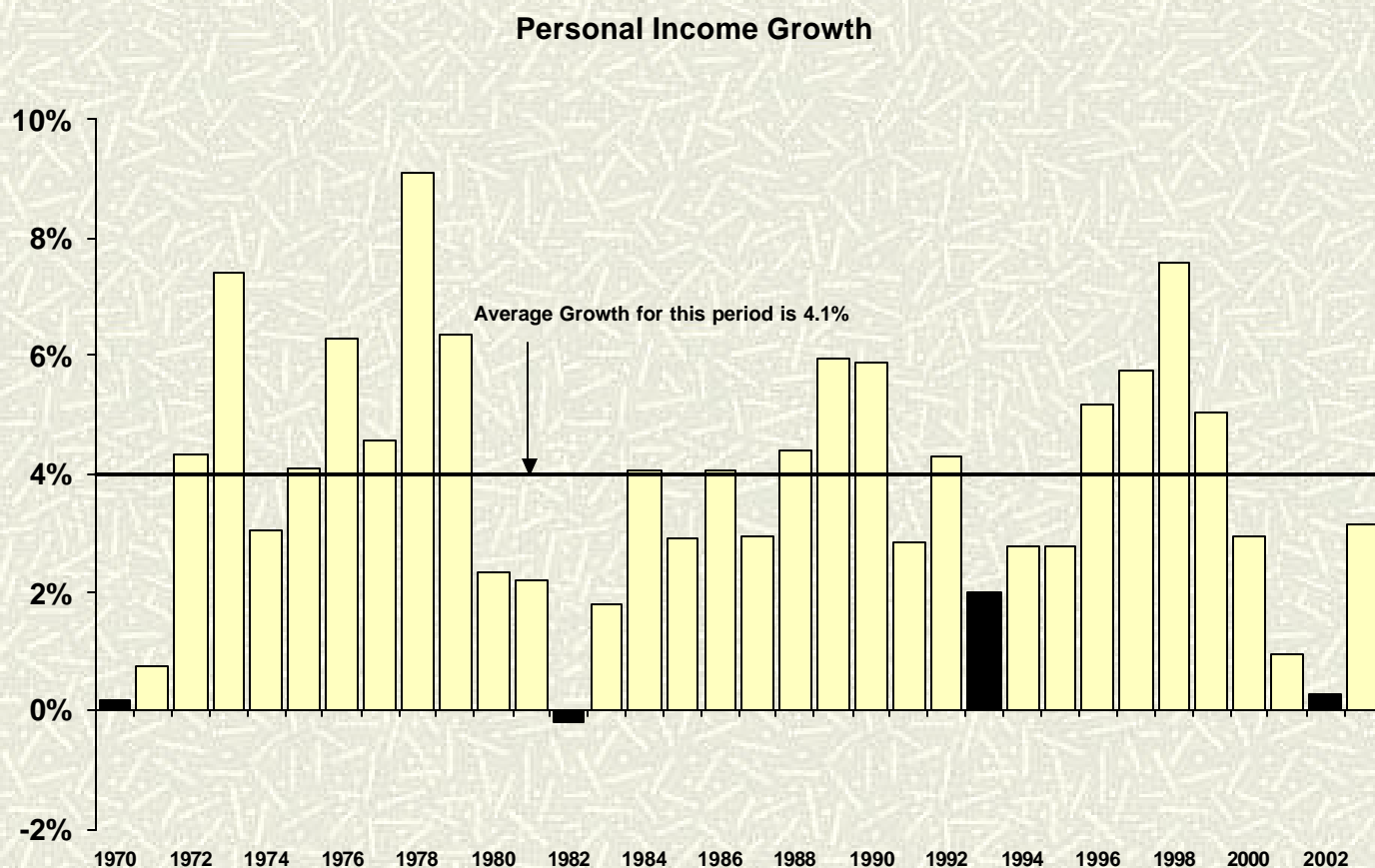
Six I-601 amendments were enacted during 2000 & 2001

- The spending limit is adopted annually by the State Expenditure Limit Committee.
- The spending limit is adjusted upward if program costs or moneys are transferred into the General Fund from other accounts.
- The Emergency Reserve Fund cannot exceed 5 percent of annual General Fund revenues.
- 75 percent of excess revenues in the Emergency Reserve Fund are deposited to the Student Achievement Fund (Initiative 728).
- \$35 million from interest earnings of the Emergency Reserve Fund are transferred annually to the Multimodal Transportation Account.
- After January 2000, any new local taxes that are credited against state taxes will result in a downward adjustment of the state spending limit.



2002 Session Budget Preview

Recessions seem to happen every decade



Source: Table A.3.3 Economic and Revenue Forecast, November 2001

The last two downturns resulted in tax increases and budget reductions

1981-83 Downturn

During the 1981-83 Biennium the state

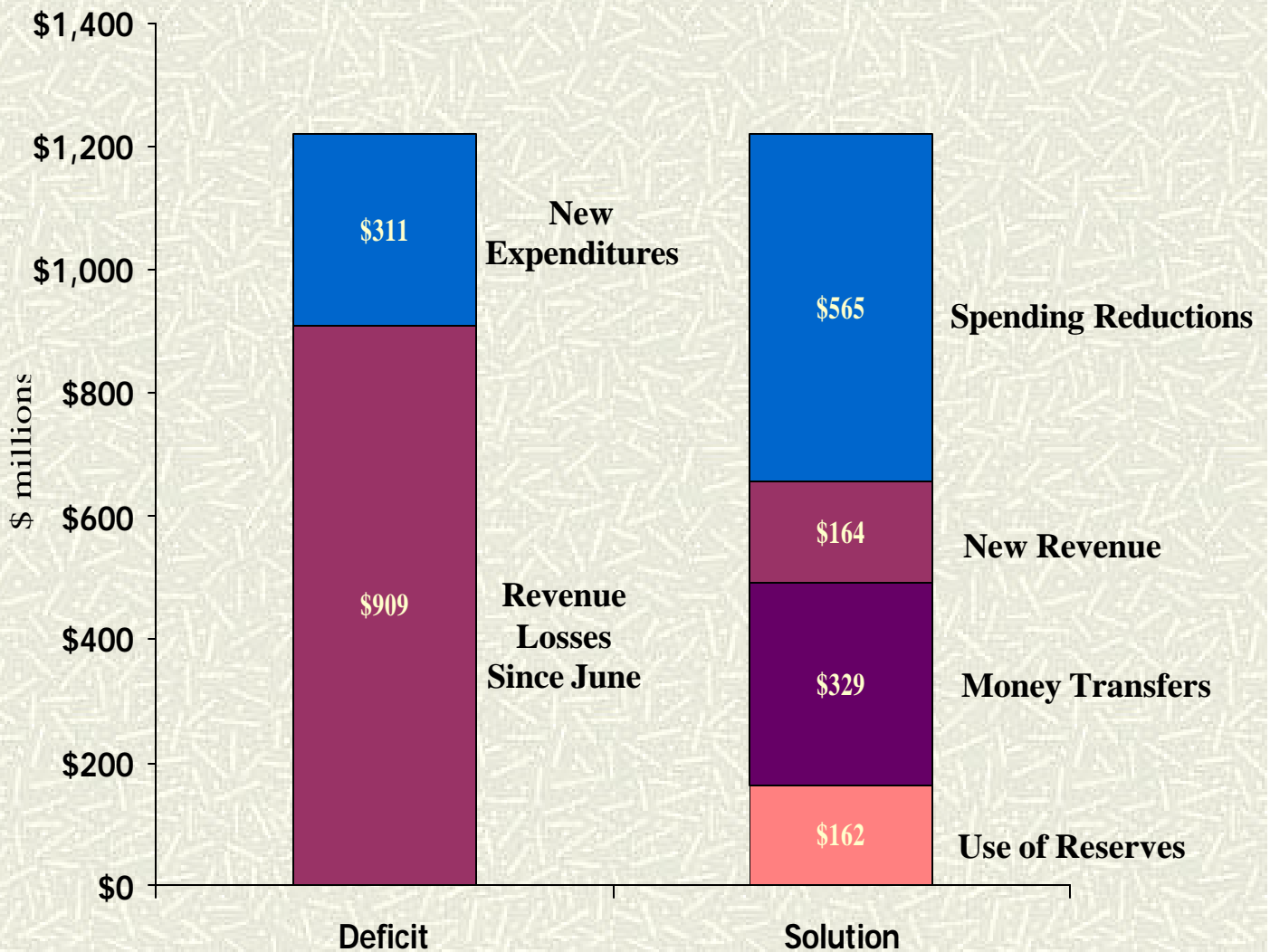
- Borrowed \$400 million
- Raised the sales tax and put the sales tax on food
- Cut basic education funding
- Eliminated the two-parent welfare program

1993-95 Downturn

During the 1993-95 Biennium the state

- Raised GF-State taxes by \$650 million
- Made \$700 million in budget reductions
- Increased tuition by almost 30% (compounded)

The Governor's Proposed 2002 Supplemental Budget



The Governor's budget proposes nearly \$600 million in budget reductions

	GF-S \$ Millions
General Reductions	
Eliminate Local Gov I-695 Backfill	(\$72.4)
Pension Rate Change	(59.8)
Health Benefits Changes/FICA Savings	(45.4)
Compensation/ Vendor Rate Delays	(12.8)
Efficiencies and Savings (Various Agencies)	(4.1)
Subtotal	(194.5)
Functional Area Reductions	
DSHS	(197.6)
Higher Education	(53.9)
Other Human Services	(44.2)
Public Schools	(28.4)
Natural Resources	(23.1)
Governmental Operations	(15.6)
Other Education	(5.6)
Special Appropriations	(2.0)
Subtotal	(370.4)
TOTAL	(\$565.0)

Source: Governor's Proposed 2002 Supplemental Omnibus Operating Budget